

AMERICAN FEDERATION OF GOVERNMENT EMPLOYEES

Affiliated with AFL-CIO

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STATEMENT BY

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BEFORE THE

SUBCOMMITTEE ON  
EMPLOYMENT AND HOUSING  
COMMITTEE ON GOVERNMENT OPERATIONS  
U.S. HOUSE OF REPRESENTATIVES

ON

"CAFETERIA" FLEXIBLE BENEFIT PLAN  
FLEXIBLE SPENDING ACCOUNT

MARCH 1, 1988

My name is Kenneth T. Blaylock. I am the National President of the American Federation of Government Employees (AFL-CIO), which represents over 700,000 active and retired government workers across the country.

I appreciate the opportunity to testify before the Committee on our views on cafeteria plans and/or flexible spending accounts for federal employees. We want to thank the Chairman and the Committee for exploring new ways to improve the compensation of federal employees.

First, we have serious reservations about considering such "cafeteria" plans or flexible spending accounts for federal employees as a substitute for the existing system of benefits (CSRS, FERS, FEHB, FEGLI, etc.) currently available to federal employees. While such cafeteria plans or flexible spending accounts have the advantage of flexibility and added choice for employees, they often undermine the principle of insurance "type" plans which is to spread "risk" over the greatest number of people. For example, the Federal Employees Health Benefit Plan, which is in some sense a "cafeteria plan" for health benefits, is plagued with adverse selection. In this context, adverse selection refers to the logical result where "low risk", "healthy" employees opt for the low cost, minimal coverage plans while "high risk" employees such as retirees become the dominant subscribers to high coverage plans thereby driving the premiums of such "high option" plans through the ceiling. What is needed for health benefits in the federal sector is not greater flexibility and choice, but better insurance.

The full-scale implementation of a cafeteria/flexible spending account approach as a further substitute for the existing benefit approach would require major revisions in the compensation and benefit programs for federal workers. The application of this approach at the activity level would require a large degree of flexibility because of the widely varying circumstances in the work force by agency and geographic areas. We would be very cautious regarding the application of these approaches to the federal workers as a substitute for our existing benefit structure. We would only be willing to seriously explore these alternatives if such alternatives also allowed for collective bargaining by the employee unions on the size and composition of such plans.

However, certain benefits widely available in the private sector, such as child care, elderly care, pre-paid legal benefits, education benefits, dental care, eye care, etc., which are not, in general, provided to federal workers may be appropriate for packaging in an employer-paid cafeteria style benefit.

In addition, the tax code allows for the establishment of flexible spending accounts which allow workers to use pre-tax dollars to pay for certain benefits such as child care costs, dependent elderly care, and health care expenses. Many companies in the private sector have been turning to the use of these flexible spending accounts for these benefits.

Yet even in these two cases, it is important to proceed cautiously. In the case of establishing an additional cafeteria style benefit, one would be adding to the

compensation package of federal employees. Instead of establishing this new cafeteria benefit, why not just increase employees' pay? In the private sector, there are clear tax advantages to employers/employees in establishing these types of plans. Employers, by and large, are able to deduct their contributions to these plans as a business cost. Employees, as they use these benefits, are not, by and large, required to claim these benefits as income. Therefore, there is a net gain to private sector employers/employees in establishing such plans.

But in the federal sector, the employer is also the nation's tax collector. For the employer/employee in the federal sector, there is no net gain to providing such benefits through a cafeteria style benefit as compared to employees purchasing such benefits directly through increased pay unless the costs of such benefits are lowered through group buying power. Even here the lowered costs would be offset through the additional costs of administering the plan.

We also have reservations in regard to establishing flexible spending accounts in the federal sector. Once again, establishing such accounts for federal employees generates tax losses for the federal government, and the federal government should be indifferent to whether it adds compensation to employees indirectly through the tax structure or directly through increased pay.

Furthermore, the benefit derived by the employee is a direct function of the tax bracket the employee is in. For example, a GS-13 manager who has an annual income of plus

\$40,000 is in the twenty-eight percent tax bracket. For every \$100 he/she places in his/her flexible spending account, he/she saves \$28. But the GS-5 secretary with an annual income of \$15,000 is in the fifteen percent tax bracket. For every \$100 he/she place in his/her flexible spending account, only \$15 is saved. This inequity is exacerbated by the fact that, in general, those in higher income brackets are better able to set aside money for such flexible spending accounts.

One of the most pressing needs for federal employees which would presumably be addressed by a new cafeteria benefit plan or flexible spending accounts is child care. Yet, child care needs are not only financial, although finances are very important, but also availability and convenience. Ideally for federal employees, all worksites of a certain size would have on-site, affordable child care. It may be the case that instead of using resources to establish new cafeteria benefits or flexible spending accounts, it may be more effective and efficient to use those same resources in establishing and subsidizing day care centers directly on federal worksites.

While the GSA is supportive of establishing child care on-site facilities, some agency heads such as Dorcas Hardy, Commissioner of Social Security, are adamantly opposed to on-site federally sponsored day care and opposed to the GSA's initiatives. Hardy will have spent \$500,000 funding a private contractor to set up a child care referral telephone line. The "service" makes available the phone numbers of child care providers in a given area. Generally, when called, the providers have long waiting lists and are prohibitively

expensive for our workers. Hardy's FY 1989 budget provides for continuation of the "Child Care Referral Project". Hardy will be throwing more Social Security Trust Fund dollars into a worthless non-response to our workers' child care needs.

Finally, although we have raised a series of concerns relating to a new cafeteria benefit and/or flexible spending account, we do not mean to close the door on their use. The federal civil service is undergoing what has been referred to as a quiet crisis. Many outside prestigious groups, such as the National Academy of Public Administration and the National Commission on Public Service, have begun to raise the seriousness of the erosion of the Civil Service. While this crisis has many causes, without a doubt the major contributing cause has been the overall deterioration of federal employee compensation compared to the private sector. Any solution, whole or partial, must seek to raise overall compensation.

It very well may be that at this time politically the only way to do so is through back door measures such as are being discussed here. If this be the case, we certainly would not want our reservation to stop this from happening.

Thank you.